Overview

- Rebound from trade-war-induced slowdown in 2019 has been gathering steam, but coronavirus and US election present new risks
  - Manufacturing was hit hardest and weakness will persist a bit longer
  - Labor market and consumers have been resilient throughout
- Our baseline forecast sees GDP growth accelerating from 1% in Q1 to 1.75% in Q4, averaging about 1.5%
- Wage growth has been solid, but core inflation looks unlikely to jump
- We look for one Federal Reserve rate cut in June
  - Ongoing “framework review” should conclude mid-year
  - One more cut will drive home shift toward average inflation targeting
- Near-term recession risks were falling, but coronavirus raises them again
  - Assuming there is no recession, will we see a more robust rebound?
Slowing global growth and trade policy risks have hurt US manufacturing, but consumer confidence has remained resilient.
US manufacturing weakness spilled into service sector somewhat; Capital expenditures have been falling.

**Composite US business sentiment indexes**

- Manufacturing
- Services

**US core capital goods spending**

- Shipments
- New orders

Source: J.P. Morgan

Source: Census Bureau, J.P. Morgan. Figures are "absorption," or orders + imports - exports.
Drags on manufacturing sector are likely to continue; Boeing 737 and coronavirus could delay rebound further.
Overall job growth had slowed, and job opening have fallen; Strong recent jobs reports suggest beginning of a rebound.
Slowdown has been limited to manufacturing-exposed industries; Unemployment insurance claims show little sign of layoffs

Private payroll growth

Initial claims for unemployment insurance

Source: BLS, BEA, J.P. Morgan

Source: Department of Labor, J.P. Morgan
Consumer sentiment surveys have wobbled a few times, but rebounded in 2020; We will watch closely for any deterioration.
Housing: Housing recovery has been tepid for years amid weak household formation

**Housing starts**

- **millions, annual rate, 6-month average**

<table>
<thead>
<tr>
<th>Year</th>
<th>Single-family</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>80</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>85</td>
<td>1.5</td>
<td>2.5</td>
</tr>
<tr>
<td>90</td>
<td>1.0</td>
<td>1.5</td>
</tr>
<tr>
<td>95</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>00</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>05</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>10</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>15</td>
<td>2.0</td>
<td>4.0</td>
</tr>
<tr>
<td>20</td>
<td>4.0</td>
<td>8.0</td>
</tr>
</tbody>
</table>

**Living situations of 25-34 year-olds**

- **Heading own household**
- **Living in parent's household**

<table>
<thead>
<tr>
<th>Year</th>
<th>Heading own household</th>
<th>Living in parent's household</th>
</tr>
</thead>
<tbody>
<tr>
<td>94</td>
<td>46%</td>
<td>9%</td>
</tr>
<tr>
<td>99</td>
<td>47%</td>
<td>10%</td>
</tr>
<tr>
<td>04</td>
<td>48%</td>
<td>11%</td>
</tr>
<tr>
<td>09</td>
<td>49%</td>
<td>12%</td>
</tr>
<tr>
<td>14</td>
<td>50%</td>
<td>13%</td>
</tr>
<tr>
<td>19</td>
<td>51%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Census Bureau, J.P. Morgan, BLS, J.P. Morgan

J.P.Morgan
Housing activity has jumped since mortgage rates dropped last year; But prices are starting to decline in hot markets.

Source: Census Bureau, NAHB, J.P. Morgan

Source: Zillow, J.P. Morgan
On net, our nowcaster of underlying GDP growth has rebounded nicely since mid-November, but we look for slowing from here.

JPM nowcasts of US GDP growth

Source: Various government and non-government sources, J. P. Morgan
Coronavirus will dramatically slow global growth and drag on US

- Case count is decelerating in China but accelerating elsewhere
- Some economic activity in China is resuming, but slower than expected
- We expect severe V-shaped effects on China output, but modest effects on US

Q1 GDP growth forecasts

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>Italy</th>
<th>US</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-virus (Jan 24)</td>
<td>6.3%</td>
<td>1.0%</td>
<td>1.25%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Current</td>
<td>-3.9%</td>
<td>-2.0%</td>
<td>1.0%</td>
<td>0%?</td>
</tr>
</tbody>
</table>

- Downside risks to US would be significant if virus spreads

China coal consumption has yet to rebound

Outbound shipping traffic has picked up
US election is on track to create more uncertainty than usual

- US elections are not always a macro event
- Major fiscal policy changes probably require sweep of presidency, Senate, and House by one party
- Even with one-party sweep, passing legislation through Senate still requires:
  - 60 votes to overcome filibuster
  - OR political will to use reconciliation
- Currently, “democratic socialist” Bernie Sanders is leading a tight race for Democratic nomination
- Significant probability of a contested Democratic convention July 13-16
- Then significant chance of Sanders vs. Trump election on November 5

Source: J.P. Morgan
Policy risks are still concerns

- **US-China Trade:** Phase 1 deal signed. US leaves most tariffs in place and China agrees to extra $200 billion in purchases over 2 years. Plan for Phase 2 is unclear, but will presumably be delayed until post-election.

- **NAFTA/USMCA:** Passed by legislatures in Mexico and US; still needs approval in Canada.

- **Brexit:** UK left EU on January 31 and now enters “transition period” until year-end under same trade rules. Negotiations will continue.

- **Auto tariffs:** US/EU trade dispute and auto tariff threats had been on backburner, but could be resurrected.

Even under assumption of rebound after trade war and coronavirus, we still forecast growth rising to only 1.75% by Q4.
Longer-run, we estimate US potential growth at about 1.5%; Labor productivity and labor supply growth have both slowed.
Labor supply: Labor force participation rate has declined since recession; Retirement of baby boomers explains a big piece
And participation in younger groups was already declining pre-crisis; Recently, prime-age women have defied downward trend.
Unemployment rate has fallen dramatically since 2010; Unclear how much further it can fall from 50-year lows
Most measures of wage growth have returned to pre-crisis levels, but have been lagging historical relationships since 2018.
Inflation has been low and stable since the mid-1990s; Core PCE inflation has fluctuated between 1.5% and 2.0%
Wage increases with no price increases mean margins get squeezed when labor markets are tight.
Fed cut 3 times to insure against recession; We expect another cut in June to conclude framework review

Sentiment about growth in FOMC minutes

Discussion of risk and uncertainty

Source: Federal Reserve, J.P. Morgan
Recession risks implied by yield curve and economic data are still somewhat elevated; Stocks still seem more optimistic.

Probability of recession beginning within 1 year

Source: Various sources, J.P. Morgan. Grey shaded areas are NBER recessions.
Most high-frequency recession indicators are back to looking fairly positive

### Probabilities based on single indicators

<table>
<thead>
<tr>
<th>Indicator(s)</th>
<th>Probability</th>
<th>Current level</th>
<th>Level at 50% probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical average unconditional probability</td>
<td>16%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer sentiment</td>
<td>12%</td>
<td>79.4</td>
<td>70.8</td>
</tr>
<tr>
<td>Nonmanufacturing sentiment</td>
<td>19%</td>
<td>61.2</td>
<td>54.0</td>
</tr>
<tr>
<td>Manufacturing sentiment</td>
<td>19%</td>
<td>57.0</td>
<td>49.2</td>
</tr>
<tr>
<td>Residential building permits</td>
<td>7%</td>
<td>1460</td>
<td>1163</td>
</tr>
<tr>
<td>Auto sales</td>
<td>31%</td>
<td>16.8</td>
<td>14.9</td>
</tr>
<tr>
<td>Payrolls</td>
<td>20%</td>
<td>211</td>
<td>-90</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>35%</td>
<td>3.6</td>
<td>3.8</td>
</tr>
<tr>
<td>Initial claims</td>
<td>16%</td>
<td>208</td>
<td>232</td>
</tr>
<tr>
<td>Senior loan officer opinion survey</td>
<td>3%</td>
<td>0.2</td>
<td>18.5</td>
</tr>
<tr>
<td>All near-term economic indicators above</td>
<td>21%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Background risk indicators</td>
<td>48%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All economic indicators</td>
<td>34%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: J.P. Morgan. "Historical average unconditional probability" is the historical average probability of a recession starting within 12 months when beginning in an expansion, unconditional on any data. All other probabilities are based on regression models.

### Contributions to overall recession risk

Contributions to probability of recession within 1 year

Source: Various government and non-government sources, J.P. Morgan
But longer-term, tight labor markets have historically signaled higher background risk of recession.

Risk of recession by unemployment rate

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1 year</th>
<th>2 years</th>
<th>3 years</th>
<th>4 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical average unconditional probability</td>
<td>16%</td>
<td>32%</td>
<td>45%</td>
<td>56%</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>48%</td>
<td>77%</td>
<td>89%</td>
<td>96%</td>
</tr>
<tr>
<td>Unemployment gap</td>
<td>39%</td>
<td>64%</td>
<td>80%</td>
<td>91%</td>
</tr>
<tr>
<td>Compensation growth</td>
<td>40%</td>
<td>66%</td>
<td>79%</td>
<td>85%</td>
</tr>
<tr>
<td>Prime-age male labor force participation</td>
<td>48%</td>
<td>78%</td>
<td>88%</td>
<td>96%</td>
</tr>
<tr>
<td>Margin draw down from 5-year peak</td>
<td>75%</td>
<td>88%</td>
<td>91%</td>
<td>91%</td>
</tr>
<tr>
<td>Durables and structures share of GDP</td>
<td>30%</td>
<td>49%</td>
<td>64%</td>
<td>78%</td>
</tr>
<tr>
<td>All background risk indicators above</td>
<td>48%</td>
<td>83%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>All economic indicators</td>
<td>34%</td>
<td>68%</td>
<td>88%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: J.P. Morgan. “Historical average unconditional probability” is the historical average probability of a recession starting within a given horizon when beginning in an expansion, unconditional on any data. All other probabilities are based on regression models. Indicators are transformed as follows: compensation growth is difference from 10-year average, prime-age male participation is the difference over three years in the 12-month average, durables and structures share is difference from 10-year average. “Composite probability from medium-term indicators” is the probability from a model based on the first principal component of the indicators in the table. “Composite from near and medium-term indicators” is the probability from a model including the first principal component of our near-term indicators and the first component of the medium-term indicators.
What vulnerabilities should we be watching?

- We find the most reliable indicator of recession vulnerability has been a tight labor market, which signals that the economy is operating beyond its sustainable capacity.

- Against this backdrop, historical recessions often involved an outbreak of inflation that led to rapid Fed tightening.

- More recent recessions involved financial overheating in the form of high asset prices and/or leverage.

- There are some signs of similar overheating today, but they look less extreme than at times in the past.

- E.g. asset valuations are high across the board, but not as high as recent cycle peaks (chart).

Corporate debt is at high levels relative to GDP or income; This is a key vulnerability in our view

**US debt to GDP ratios**

**Nonfin. corporate net-debt-to-income ratio**

**ratio to GDP**

Household debt

Federal govt debt

Nonfin corporate debt

**ratio of net debt to EBITDA proxy**

Cyclically-adjusted

Source: Federal Reserve, J.P. Morgan

High federal government debt will stir debate about room for stimulus; But low rates and low risk of US debt crisis mean it might make sense

- Debt crises in countries like the US post-WWII have been very rare
- Plus, Federal Reserve can create dollars to buy debt to prevent crisis to preserve maximum employment and price stability
- Constraints on US fiscal stimulus will be primarily political
- But fiscal stimulus has generally not been enough to stop recessions
Traditional durables and structures investment not especially elevated; But high-tech investment levels have risen quickly recently.

Past equipment and housing booms:

- Business equipment
- Residential investment

High-tech investments:

- Software
- Research and development
- Information processing equipment

Source: BEA, J.P. Morgan
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